

**JOHNSON
HAILEY**
INVESTMENTS

To Investors and Friends

I am pleased to report to you on certain relevant economic factors and on my activities during the first quarter of the year. This letter will highlight commercial mortgage activity as well as provide an update on the Atlanta economy.

Interchange Business Center closed

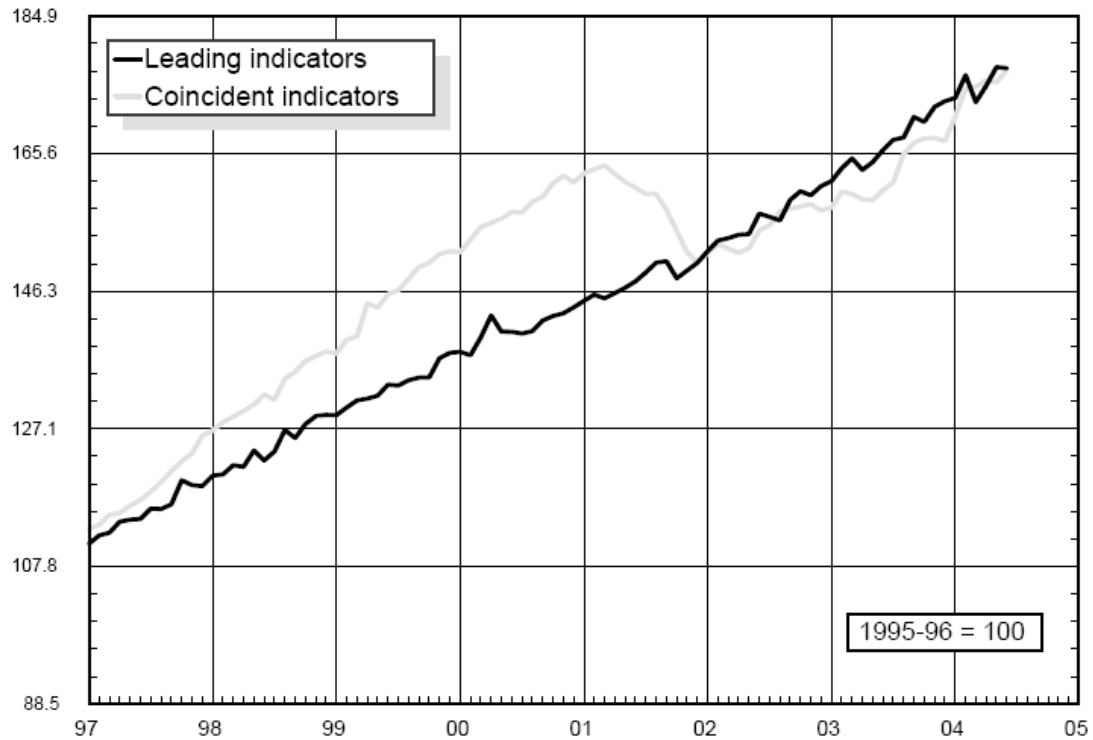
The acquisition of the 97,108 square foot flex, industrial project, which I mentioned in last quarter's report has closed. This property is 81% occupied by 10 tenants. There is no rollover for the remainder of the calendar year, with the greatest concentration of tenant rollover in 2005 and 2006. The product was originally built to be sold individually as condominium units. Thus, the physical characteristics are materially higher quality than typical speculative product. Items such as full, store-front glass, concrete truck courts, and higher grade insulation, distinguish this property from the competition in the immediate area.



Atlanta Area Economy Putter Along

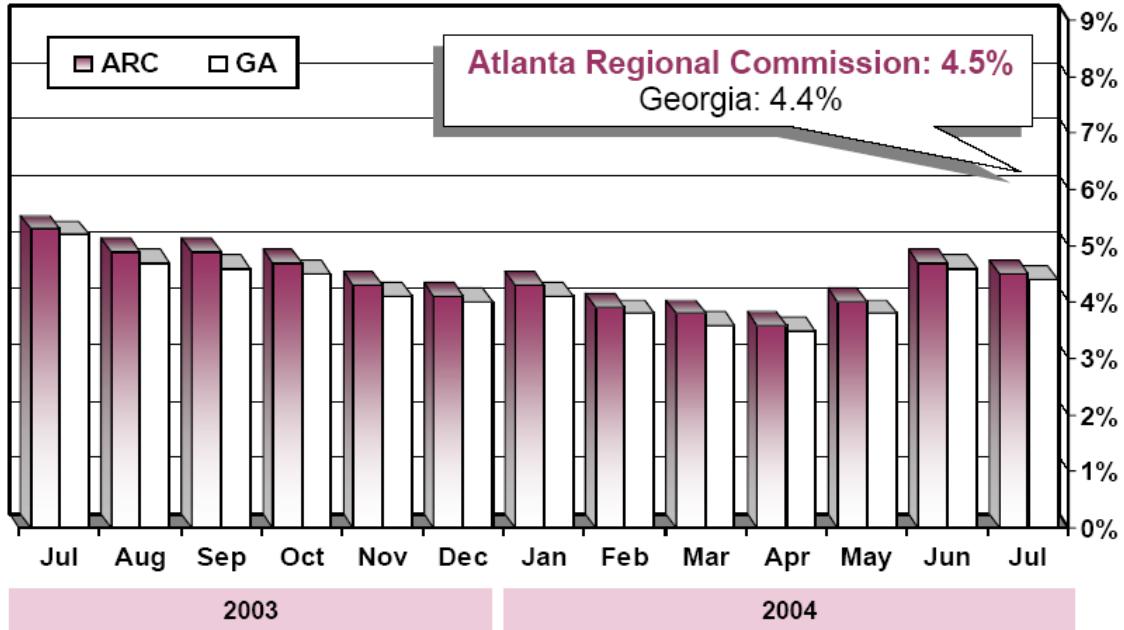
Though the leading economic indicators for the Atlanta metro area showed improvement during the second quarter, the increase was minor. More importantly, this increase was the result of construction activity—again. However, for the second quarter, it was commercial construction, not residential that led. Presumably, this is due to the increase in interest rates we saw during the quarter tempering the residential sector.

Metro Atlanta Index of Economic Indicators



Employment was down, slightly, for the quarter, as the unemployment rate increased to 4.4% from under 4% at the end of the first quarter.

Atlanta Regional Commission Compared to Georgia



Note: Atlanta Regional Commission includes Cherokee, Clayton, Cobb, DeKalb, Douglas, Fayette, Fulton, Gwinnett, Henry and Rockdale counties.

Source: Georgia Department of Labor - Michael L. Thurmond, Commissioner

The industrial and warehouse market in Atlanta continues to provide encouragement that the long-anticipated rebound is in sight for the sector. The most positive factor is another quarter of positive net absorption of available space. The Atlanta industrial market recorded positive absorption of 400,000 SF in the second quarter. Though minor in relation to 68 million square feet of vacant space, this does reflect the fourth positive absorption quarter out of the past 5 quarters. On the worrisome side is continued new development. Though the second quarter saw a relatively quiet 500,000 SF in new deliveries, this is on the heels of a very robust first quarter, when over 3 million SF were brought on-line. Without a material increase in job creation, it will be a slow climb for the industrial (and just about every other sector) market.

Investment Pipeline

Where the number of deals put out to market has increased, this is in the face of ample capital. From a recent conversation with a former associate in the pension investment management business, this pension fund manager has more capital coming in to invest in real estate than it can handle. It is, literally, creating a queue for investors to stand in line for the next real estate investment. Though I focus on product type that is smaller and

more management intensive than the fund managers and, hopefully avoid the price competition that accompanies their interest, we are seeing some fund managers reducing their minimum investment size and broadening the range of acceptable properties.

My current pipeline is as follows:

Goddard Industrial Portfolio—I bid on only one of the six separate industrial properties included in this portfolio. The one I bid on comprised a two-building, 168,000 SF flex industrial property located in the Northwest submarket of metro Atlanta. My bid was approximately 85% of the offer price and I am awaiting word from the seller.

Kennestone Corporate Center—This is a five-building, 82,633 square foot flex-office property located in the northwest section of the Atlanta metro. The project is currently 69% leased but another 18% is expected to vacate at the end of their current leases. The product is of good quality and located in a solid long-term market. This is, obviously, more of an opportunistic play.

5730 Glenridge Drive—This is a very-well located office building in the 400 corridor. It also has short-term leasing challenges that require an opportunistic view for acquisition.

Dead Deals:

4690 Hammermill Road—This is a small, four-tenant industrial property located near Stone Mountain, comprising approximately 39,000 square feet. My bid of about 20% less than the asking price from the seller, did not elicit a response. The broker stated that the seller is attempting to fashion a sale to one of the tenants.

877 West Peachtree—Though located in the booming Midtown market of Atlanta, this building is old and suffers from inadequate on-site parking. Additionally, the market for medical office space (for which this building is primarily suited) is currently soft with the development of a Cousins property across the street.

Pavillion at Windy Hill—This medical building was offered for \$10,000,000. Though the current return would have equaled 10% on current leasing, many of the leases had only been renewed for one year and the building was facing significant short-term rollover exposure. I declined due to the lease exposure and to the uncertain future of the adjoining hospital.

524 West Peachtree—This single-tenant office building was privately offered at a price of \$10,000,000. My bid of \$7,500,000 was too low for the seller. I underwrote the transaction to assume that the tenant would vacate at the end of their 10-year lease. The releasing costs would have resulted in a basis in the property greater than could be reasonably concluded the building was worth.

2148 American Industrial Way—This 213,880 square foot industrial is located in an improving area of close-in north Atlanta, providing the property with significant upside in use. Unfortunately, the seller wanted to realize this upside through sale before the market had moved and my bid for \$5,500,000 was too much below the offer price of \$6,850,000.

EAP Industrial—This was a four building, 514,882 square foot industrial portfolio of two well-located properties and two properties in a weak sub-market. No offer price was given. I bid \$16,000,000 tempered by my view of lease rates in the two sub-markets. Reportedly, the portfolio will sell above \$19,00,000.

Though I believe that deal flow will continue to increase, I fear that the majority of the opportunities will present leasing challenges. Thus, establishing a market price is very difficult due to the numerous assumptions to be made on lease-up. The worse trap to fall into is the one constructed of impatience. The incredible appetite of pension funds for commercial real estate could well drive impatience on the part of pension fund managers to put that 'hot' money to work. The assumptions they are making to justify their prices could come back to haunt them.

Please feel free to contact me if I can answer any questions or be of service.

JOHNSON HAILEY INVESTMENTS, LLC
1819 Peachtree Road, NE
Suite 550
Atlanta, Georgia 30309
(404) 350-1658 direct
(404) 355-9300 Ext. 216 main
<mailto:bjohnson@haileyrealty.com>